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BEFORE THE
Federal Communications Commission
WASHINGTON, D.C.

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DEC 16 1994

FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF SECRETARY

In the Matter of)

TELEPHONE COMPANY-)
CABLE TELEVISION)
Cross-Ownership Rules,)
Sections 63.54-63.58)

and)

Amendments of Parts 32, 36,)
61, 64, and 69 of the)
Commission's Rules to)
Establish and Implement)
Regulatory Procedures for)
Video Dialtone Service)

CC Docket No. 87-266

RM-8221

COMMENTS OF HOME BOX OFFICE IN
THE THIRD NOTICE OF PROPOSED RULEMAKING

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**COMMENTS OF HOME BOX OFFICE IN
THE THIRD NOTICE OF PROPOSED RULEMAKING**

Home Box Office ("HBO"), a Division of Time Warner Entertainment Co., L.P., hereby submits its Comments in the above-captioned proceeding.¹

INTRODUCTION

In this Notice, the Commission seeks comments on a number of important matters, including digital technology, system expandability, channel sharing, and preferential treatment, all of which raise the issue of video dialtone ("VDT") system

¹ Memorandum Opinion and Order on Reconsideration and Third Further Notice of Proposed Rulemaking, CC Docket No. 87-266, RM-8221 (rel. November 7, 1994) ("VDT Recon Order").

capacity.² Capacity will influence the types and variety of services offered over VDT systems and will be a key determinant of consumer acceptance.

These capacity issues are all interrelated. Since system capacity ultimately is finite, the Commission's decisions regarding the amount of bandwidth to be allocated to digital technology necessarily affect the amount of analog bandwidth that will be available. Likewise, preferential access for certain types of programmers would necessarily affect the telcos' ability to provide nondiscriminatory access to other programmers and may, in turn, require a more onerous expandability obligation.

The Commission should resolve these issues with reference to the underlying goals established in the VDT Recon Order:³

- facilitating competition in the provision of video programming services;
- fostering the availability of new and diverse programming; and
- promoting development of an advanced telecommunications infrastructure.

In addition, the Commission's decision in the VDT Recon Order to retain the common carrier model for VDT⁴ also makes it appropriate for the Commission to adopt rules in this proceeding

² In addition to the issues raised in this proceeding, there are a number of other issues relating to the legality of video dialtone generally. These Comments are not intended to reflect HBO's views on those issues. Rather, HBO addresses here only issues raised in the Third Further Notice Of Proposed Rulemaking.

³ VDT Recon Order at ¶ 16.

⁴ Id. at ¶¶ 30, 31.

premised upon the concept of nondiscriminatory access for programmers. The positions HBO recommends below are consistent with that approach.

Specifically, HBO recommends that the Commission:

- Permit VDT packagers to acquire sufficient analog capacity to ensure that a package of video programming that is comparable to packages provided by other multichannel video program distributors can be offered to consumers;
- Require telcos providing VDT to expand channel capacity as required to permit non-discriminatory access for programmers;
- Require telcos to provide digital VDT capacity to programmers on the same basis that telcos are required to make analog VDT capacity available;
- Permit channel sharing as a method of addressing capacity shortages, but impose conditions on such arrangements; and
- Neither mandate nor permit preferential VDT treatment for any class of programmers.

I. THE COMMISSION SHOULD NOT PERMIT TELCOS TO STRUCTURE VDT IN A WAY THAT PROHIBITS PACKAGERS FROM ACQUIRING SUFFICIENT CAPACITY TO ENSURE THAT VIABLE, COMPETITIVE PACKAGES OF VIDEO PROGRAMMING CAN BE OFFERED TO CONSUMERS

The Commission's competition and program diversity goals will be undermined if telcos can effectively prevent packagers from obtaining enough capacity to provide packages of services that are comparable to and competitive with those offered by other multichannel video program distributors ("MVPD"). HBO's experience is that consumers consistently demand packages of program services. If VDT packagers are precluded by telcos from assembling packages that are comparable to those of other MVPDs, not only will the competitive vitality of VDT suffer, but the

underlying goals of programming diversity and infrastructure development will also likely be impeded.

It is unlikely that either the Commission or HBO could determine the appropriate maximum capacity a single packager should be allocated in all circumstances. These judgments will have to be made on a case-by-case basis and the Commission will be required to balance the need for a competitive package against the desire to provide capacity for all programmers who desire it. Such judgments will depend on many factors -- for example, the total capacity available on the VDT system, demand among programmers and packagers, and the offerings of other MVPDs in the areas served by the VDT system. In order to add some measure of predictability to this process, HBO recommends that the Commission: 1) confirm that packagers will be able to obtain sufficient capacity; and 2) make clear that in considering the amount of capacity allocated to a single packager, the Commission will give considerable weight to the principle of comparability with alternative MVPDs.

II. THE COMMISSION SHOULD REQUIRE TELCOS TO EXPAND VDT ANALOG CAPACITY AS REQUIRED BY PROGRAMMERS

In the VDT Recon Order, the Commission reaffirmed that telcos providing VDT will be required to expand capacity to meet programmer demand, noting that such a build-out requirement is necessary to achieve the underlying goals of program diversity and infrastructure development.⁵ HBO agrees with that decision.

⁵ Id. at ¶ 36.

The expandability requirement also is necessary in light of the need discussed above to permit a single entity to acquire enough capacity to provide consumers with a competitive package of services. The Commission has noted that in the absence of a build-out requirement the initial VDT programmers "might exhaust all video dialtone capacity."⁶ With most VDT systems proposing 60-80 analog channels, a single entity attempting to offer a competitive program package could seek to acquire half or more of the channels. In such situations, the expandability requirement may be necessary to satisfy the needs of multiple programmers, and in some instances will undoubtedly be essential to the development of multiple program packages.

III. THE COMMISSION SHOULD CLARIFY CERTAIN ISSUES RELATING TO THE AVAILABILITY AND COST OF DIGITAL VDT CAPACITY

A. Telcos Must Make Digital VDT Capacity Available To Programmers On The Same Terms As They Are Required To Make Analog Capacity Available

HBO understands the Second Report and Order and the VDT Recon Order to require telcos to make digital VDT capacity available to programmers on the same basis that the telco is required to make analog capacity available. HBO believes that programmers must have access to digital VDT capacity for two critical reasons.

First, digital capacity is necessary for the provision of interactive services, which cannot, as a practical matter, be provided in an analog environment. HBO is exploring the use of

⁶ Id.

VDT facilities for two-way services, such as HBO-on-demand. HBO wants to be able to deliver interactive services to consumers, either directly or through programming packagers. HBO is concerned, however, that some telcos may not believe the VDT rules require them to make digital capacity available. HBO has had discussions with some telcos in which the telcos indicated that they intend to use digital capacity for the use of their own affiliated programming business but have not indicated that they intend to make digital capacity available to other programmers. A telco reservation of digital capacity is fundamentally at odds with the common carrier framework the Commission has established. If telcos are permitted to deny all or substantially all digital capacity to programmers, thus reserving to themselves the exclusive right to use VDT to provide interactive services to consumers, the goal of fostering the availability of new and diverse programming would be seriously undermined.

Second, digital capacity is the only realistic means to significantly expand VDT channel capacity. The largest capacity analog video distribution system in existence today has 1 GHz (1000 MHz) of spectrum. In fact, today's state-of-the-art cable systems are being constructed with no more than 750 MHz. Even if larger bandwidth analog systems could be designed and built, there are no analog set-top boxes in existence today that can accomodate more than 750 Mhz capacity. The inherent limits of analog technology are reflected in the fact that telcos generally

propose VDT systems that have only 60-80 analog channels but hundreds of digital channels.

Digital capacity allows program services to be compressed, so that several services can be provided over the same 6 Mhz of bandwidth that is capable of delivering only one service in an analog environment. Compression ratios will vary depending on the quality desired and the type of programming delivered.⁷ Generally, digital compression ratios range from 4:1 to 8:1. Thus, for example, in an analog environment, 30 Mhz is sufficient to distribute only 5 program services (6 Mhz per channel), while in a digital compression environment, the same 30 Mhz could deliver 20-40 program services.

B. The Commission Should Clarify The Cost Issues Raised By The Deployment And Use of Digital VDT Capacity

The extent to which digital technology can mitigate the capacity problems at issue in this proceeding will depend on the costs associated with deploying and using the technology. If the costs are too great, the deployment and use, as well as the potential benefits, of digital technology will be delayed.

In the Notice, the Commission asks for comment on a VDT proposal by GTE that would make extensive use of digital capacity. The GTE proposal presents an example of the important cost issues raised by digital technology. Under GTE's proposal,

⁷ Programming with a lot of action, such as sports events, require higher data rates and, therefore, will have a lower compression ratio. Programming with little visual movement, such as a talk show, will require a lower data rate and will have a higher compression ratio.

programmers have the option of delivering to GTE an analog or digital signal. If a programmer delivers an analog signal, GTE will either modulate the signal onto an analog channel, or encode and multiplex the signal onto a digital bit stream to be delivered over the VDT system. GTE would require all subscribers to purchase or rent a set-top converter that is capable of making digital signals viewable on today's televisions.

However, the costs associated with the GTE proposal are unclear. For example, will GTE impose an additional cost on programmers to undertake conversion from analog to digital? If so, in what form will the charge be imposed (e.g., as a separate charge or bundled in the tariff rate)? What will be the level of such a charge? If a conversion charge is imposed, HBO believes that it should be pursuant to a regulated tariff. Otherwise, GTE will have the ability set prices that thwart the Commission's diversity, infrastructure, and competition goals.

GTE's proposal also raises a significant cost issue for consumers. The proposal requires every VDT subscriber to have a digital set-top box. The Commission has noted that the current cost of such a box is approximately \$300.⁸ Whether GTE sells or leases the boxes, there is likely to be some consumer resistance to the cost, and that will impede the growth and success of VDT. Telcos may seek to offset this result by shifting the cost of the box elsewhere. For example, telcos could attempt to impose a higher tariff on programmers as a method of subsidizing the box

⁸ Id. at ¶ 268.

cost. Similarly, telcos might assert that the digital box performs traditionally "network" functions and therefore the cost of the box should be borne, at least in part, by all subscribers.

Until these cost issues are clarified, it is not possible to fully analyze the GTE proposal or, in fact, the potential of digital technology generally. Cost will impact the attractiveness of VDT to consumers and programmers and, therefore, will have a significant impact on the competitiveness of the technology. Because of the importance of digital technology from the standpoint of capacity and interactivity, HBO urges the Commission to resolve these issues as expeditiously as possible.

IV. THE COMMISSION SHOULD IMPOSE CONDITIONS ON CHANNEL SHARING ARRANGEMENTS

The Commission tentatively concluded that channel sharing arrangements, if properly structured, have the potential to enhance the overall effectiveness of VDT by, for example, reducing capacity shortages and increasing the potential for multiple competitive program packages. However, channel sharing poses potentially significant problems for programmers. For example, channel sharing may have implications for program security, disconnection of non-paying subscribers, marketing, billing and collection, and disaffiliation with non-paying packagers. These problems could be more complicated depending on the role of the channel sharing manager or facilitator.⁹

⁹ VDT Recon Order at ¶ 273.

It is difficult at this time for HBO or the Commission to accurately assess the nature and extent of these problems because channel sharing arrangements have not previously been utilized to distribute video programming. As a result, HBO recommends that the Commission make clear that individual programmers retain their rights to negotiate all relevant conditions with each packager that seeks authority to distribute programming on a channel-shared basis. To the extent that there is a channel sharing manager or facilitator, its role should be strictly limited and it should not have the power to restrict in any way a programmer's right to establish the terms and conditions under which its programming may be delivered.

HBO also agrees with the Commission's decision to establish specific conditions to govern channel sharing arrangements. HBO recommends the following conditions:

- No programmer may be required to allow its programming to be used in a channel sharing arrangement.
- Telcos may not discriminate against a programmer, in terms of access or price, because the programmer refused to permit its programming to be used in a channel sharing arrangement.
- The adoption of channel sharing rules should not impose on programmers a duty to deal with a particular packager. Similarly, channel sharing should create no inference against exclusive distribution arrangements between programmers and VDT packagers.
- In the absence of strong technical or economic impediments, any programmer may seek to have its programming distributed on a channel-shared basis. The burden should be on the telco to demonstrate such impediments.

- Telcos may not use channel sharing as a means to give preferential treatment to a particular group of programmers. (HBO's legal and policy reasons for opposing preferential treatment are set forth below.)
- Any channel sharing manager or facilitator must be independent from the telco.
- Programmers should have the option (but not an obligation) to sublicense distribution rights to a channel sharing manager or facilitator.

V. THE COMMISSION SHOULD NEITHER MANDATE NOR PERMIT PREFERENTIAL TREATMENT FOR ANY CLASS OF PROGRAMMERS

Preferential access to VDT for certain programmers, whether mandated by the Commission or voluntarily implemented by VDT operators, would violate Title II of the Communications Act. In addition, FCC mandated preferential access rules would violate the First Amendment. The Commission should therefore reject preferential access proposals for VDT.

Under the common carrier model adopted by the Commission for VDT, telcos must (1) provide service to all who make a "reasonable request therefor,"¹⁰ (2) ensure that charges for such services are "just and reasonable,"¹¹ and (3) provide cable service only upon compliance with the franchise and other requirements set forth in the Communications Act.¹² Preferential access to VDT violates all three elements of this regime and must therefore be rejected.

¹⁰ 47 U.S.C. § 201(a).

¹¹ 47 U.S.C. § 201(b).

¹² See 47 U.S.C. §§ 521-59.

First, a common carrier may not use capacity for any purpose if it limits its ability to offer service to all who make a reasonable request therefor.¹³ Thus, to the extent that VDT providers' "will carry" proposals threaten their ability to provide analog service to all who reasonably request it, the Commission should not permit them.¹⁴

Second, preferential access would violate the common carrier requirement of just and reasonable prices by forcing non-preferred programmers to subsidize preferred programmers. Such a subsidy would be unjust because neither the Commission nor any of the parties to this proceeding has demonstrated that subsidization is necessary for the survival of any of the proposed categories of beneficiaries. Nor is it clear that any benefits derived from subsidies would outweigh the substantial market distortions they would cause, for example, the investment

¹³ Cf. Domestic Fixed-Satellite Transponder Sales, 90 FCC 2d 1238, 1254-55 (1982) (permitting common carriers to use a portion of their satellite transponder capacity for non-common carrier purposes only after determining that enough capacity would be available to serve all who reasonably request it); Michigan Consolidated Gas Co. v. FPC, 283 F.2d 204, 214, 218 (D.C. Cir. 1960) (affirming FPC decision to permit natural gas provider subject to common carrier regulation to sell gas on a non-common carrier basis only after finding that there remained an adequate supply to meet the provider's common carrier obligations).

¹⁴ Bell Atlantic's proposal, for example, is impermissible under this standard because it involves the allocation of 37 channels for local broadcast and PEG programming, VDT Recon Order at ¶ 272 n.510, leaving only about half of the remaining analog channels for the common carrier platform. That is simply not enough capacity to offer service to all who reasonably request it, particularly if a single entity desires to provide a program package comparable to other MVPDs.

in programming that viewer demand would not otherwise support. That result not only contravenes the just and reasonable price requirement but it also subverts the Commission's goal of providing an incentive for the creation of new and diverse programming.

Third, permitting telephone companies voluntarily to favor certain channels would involve the telcos in the provision of cable service that is permissible only upon compliance with the requirements of Title VI of the Communications Act. Indeed, the Commission originally exempted VDT from the requirements of Title VI largely because VDT providers would not be involved "in the selection and distribution of video programming,"¹⁵ and the D.C. Circuit relied on this distinction to affirm the FCC's decision to exempt VDT from Title VI.¹⁶ Once telcos cross the threshold and become involved in the selection of programming, as they would in any "will carry" proposal, they should become subject to all of the same requirements the Communications Act imposes on cable operators. Until the telcos fulfill these requirements the Commission should not permit them to become involved in the selection of video programming by voluntarily granting preferential access to certain video programmers.

¹⁵ Telephone Company-Cable Television Cross-Ownership Rules, Sections 63.54-63.58 Memorandum Opinion and Order on Reconsideration, 7 FCC Rcd 5069, 5071 (emphasis added).

¹⁶ See National Cable Television Ass'n v. FCC, 33 F.3d 66, 71, 74 (D.C. Cir. 1994).

Finally, there are two additional reasons why the Commission should reject preferential treatment: 1) by limiting the channel capacity available for new programming, it is at odds with the goal of providing an incentive for the creation of diverse programming not currently available; and 2) Commission mandated preferential access would inevitably involve the Commission in the regulation of programmers' speech and such a scheme would in all likelihood not pass First Amendment muster.

CONCLUSION

For these reasons, HBO respectfully recommends that the Commission adopt VDT rules consistent with the recommendations contained herein.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I, Thomas Jones, do hereby certify that on this 16th day of December, 1994, copies of the foregoing "Comments of Home Box Office In The Third Notice of Proposed Rulemaking" were delivered by first-class, postage pre-paid mail to the following parties:

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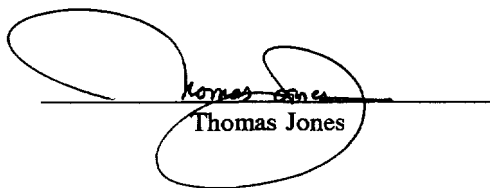
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